

REIT Alert

An informational newsletter from Goodwin Procter's Real Estate Capital Markets Group

SEC Seeks Improved Disclosure by Non-Exchange Traded REITs

Recently, the staff at the SEC (the "Staff") communicated to non-exchange traded REITs an effort intended to make prospectuses more concise, informative and useful to investors by encouraging these REITs to file more streamlined prospectuses that include additional business and financial information.¹ The Staff's revised views concerning the application of disclosure and compliance requirements during the initial distribution (offering) period, combined with the recent amendments to Form S-11 that permit incorporation of previously filed SEC reports by reference, are intended to change current practices which resulted in large part from the requirement to file sticker supplements to describe acquisitions that become probable following the initial effective date of the registration statement and the inability of REITs using Form S-11 to incorporate historical information from previous filings by reference.

Expanded Disclosure of Current Information – the Operating Supplement

Under the new approach, investors would receive a base prospectus that incorporates previously filed information by reference and a single quarterly "operating supplement" that provides an update of portfolio data and operating performance. This is in contrast to the historical practice of distributing post-effective amendments that often contained several sticker supplements describing both probable and completed acquisitions, which resulted in a multi-layer disclosure document that presented detailed information on a property-by-property basis in several different sections, but did not present unified information about the REIT's portfolio as a whole. The expansion of existing disclosure of business and financial information is intended to provide a "snapshot" of portfolio data, acquisition activity and overall operating performance. Specifically, the Staff will encourage disclosure of the following:

- general portfolio operating information, including the number of properties, 10% tenants, occupancy rates, lease expirations and average effective annual rents per square foot, similar to the information required by Items 14 and 15 of Form S-11;

¹ For the purposes of this Alert, references to non-exchange traded REITs apply only to the period during which these REITs are subject to Industry Guide 5.

- diversification of the portfolio by geographic region and property type, such as office, apartment, industrial and shopping centers;
- discussion of acquisition activity during the most recently completed fiscal quarter, including total costs, occupancy, property type and yields on such acquisitions based on capitalization rates determined using forward or historical financial measures such as net operating income (NOI)²;
- distributions paid during the most recent period and the cash flow from operations or funds from operations (FFO) available to source such distributions;
- selected financial information like that required by Item 301 of Regulation S-K;
- discussion of overall company financial performance with period-to-period comparisons, which could include disclosure of performance metrics such as FFO per share;
- discussion of overall portfolio performance, which could include disclosure of performance metrics such as same store NOI;
- for each type of fee disclosed in the base prospectus pursuant to Item 4 of Guide 5, disclosure regarding both the amounts of any fees paid as well as any amounts accrued but unpaid; and
- the amount of securities sold to date in connection with the offering, the amount remaining to be offered, whether the registrant has broken escrow, if applicable, and the offering termination date.

Non-exchange traded REITs that fail to disclose this type of information should be prepared for Staff comments requesting such disclosure before the post-effective amendment will be declared effective. The Staff also has suggested that to further reduce the size of post-effective amendments and to take advantage of the now permitted incorporation by reference, it will encourage non-exchange traded REITs to file post-effective amendments in close proximity to when their Form 10-Q quarterly reports are filed.

Changes in Reporting for Acquisitions

In conjunction with the amendments to Form S-11, the Staff has also aligned the materiality and timing requirements for filing Rule 3-14 financial statements during the Guide 5 distribution period with the existing Item 2.01 Form 8-K

² Note that non-GAAP financial measures, such as NOI and funds from operations, are subject to various disclosure requirements under Regulation G and Item 10(e) of Regulation S-K.

filing requirements for completed property acquisitions. Under the new materiality threshold, Rule 3-14 financial statements for completed acquisitions would only be included in the Item 20.D of Guide 5 post-effective amendment for properties that represent 10% of the REIT's *total assets* as of the date of acquisition. This compares to the prior threshold which required Rule 3-14 financial statements at the 5% of *net proceeds* significance level. The new interpretation thus modifies both the percentage (10% versus 5%) and the base (total assets versus net proceeds). It is important to note that this revised interpretation only applies during the initial distribution period. Once the net proceeds of the offering are completely invested, the standard measure of determining significance for purposes of filing an Item 2.01 Form 8-K (10% or more of the registrant's total assets as of its latest fiscal year end) will apply.

The Staff has also revised its interpretations to align the timing requirements for filing Rule 3-14 financial statements during the distribution period with the existing Item 2.01 Form 8-K filing requirements for completed property acquisitions. Non-exchange traded REITs subject to the Item 20.D undertaking will not have to include Rule 3-14 financial statements in a post-effective amendment until the Rule 3-14 financial statements have been or are required to be filed via Form 8-K (*i.e.*, up to 71 calendar days after the date that the initial report on Form 8-K was filed disclosing the acquisition). This will largely permit non-exchange traded REITs to satisfy the requirement to include such Rule 3-14 financial statements in their post-effective amendments by incorporating by reference the relevant Form 8-K. Previously, Rule 3-14 financial statements were required in the quarterly post-effective amendment even if the acquisition was completed one day before the post-effective amendment was due. Non-exchange traded REITs will still need to determine if a sticker supplement is required in connection with a material acquisition before the 71-day period if the prospectus would be materially misleading without such information.

Use of Incorporation by Reference

As discussed in our January 8, 2008 REIT Alert, "[SEC Proposes to Revise Form S-11 to Permit Incorporation by Reference](#)," the SEC adopted amendments to Form S-11 on April 10, 2008, to permit incorporation by reference of historical information.³ Accordingly, the Staff now expects registrants to simply incorporate all Exchange Act reports filed during the preceding three-month period into the post-effective amendment required to be filed pursuant to Item 20.D. This would be in lieu of consolidating all of the previously filed sticker supplements into the post-effective amendment itself. Instead of a post-effective amendment consisting of an aggregation of property financial statements, the post-effective amendment would consist of the base prospectus and one sticker supplement (discussed above) that focuses on material business information.

³ Adopting Release No. 33-8909 (effective as of April 15, 2008).

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